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SUBJECT: TOUGH WEEK FOR AUSTRALIAN ECONOMY

REF: A. CANBERRA 1010
[1](#)B. MELBOURNE 114

[1](#)1. (U) Summary: This was a bad week for Australia's economy, primarily because of the effects of the global financial crisis. Stocks down 16%. Australian dollar down over 10%. Commodities softening, confidence down, unemployment up. Rudd is making reassuring statements and announced a new bank deposit insurance scheme, but people are nervous and the word "recession" is in the air. End summary.

Share Prices Plunge

[1](#)2. (U) Australia has been watching the global financial crisis nervously for months, hoping it would escape without too much damage. But this was a very bad week for the Australian economy. Despite the Reserve Bank's unexpectedly deep slash of its key official cash rate (from 7% to 6%, ref A) and the subsequent interest rate cuts by the Federal Reserve and 20 other central banks, the Australian Stock Exchange (ASX) has followed Wall Street and other stock markets downhill. The All Ordinaries index lost 5% in the first 15 minutes of trading, rallied briefly in the early afternoon, but ended up down 8% for the day, breaking (in the wrong direction) the 4000 mark. For the week it has shed 16% of its value (A\$170 billion) dropping to levels not seen since mid-2005.

[1](#)3. (U) Although the GOA and the Australian Prudential Regulatory Authority assure that they are sound, Australian banks, despite the boost from the RBA rate cut on Tuesday, had a particularly bad day - each of Australia's big four banks was down 5% or more on Friday trading. Struggling investment banks Macquarie and Babcock & Brown were both down over 10%. The Australian dollar has dropped sharply, losing well over 10% of its value in a week - the biggest weekly decline since it was floated in 1983. The Aussie dollar was near parity with the greenback in July at a peak of US\$.985; it has dipped as low as US\$.642 this week - and could weaken further if global commodity prices continue their drop. The Future Fund (a sovereign wealth fund based on GOA surpluses to fund public sector pensions) is believed to have lost over A\$2.6 billion over recent weeks.

Commodities Weakening

[1](#)4. (SBU) Commodities have been the backbone of Australia's economic boom over the past five years, but weakness is developing there as well. Mining companies in WA tell ConGen Perth of iron exports to China being postponed, news that is also reaching the press. There are several factors behind

this: reduced Chinese steel output in the face of plummeting steel prices; declining demand for steel globally; and problems some Chinese traders report in getting credit from Chinese banks to finance imports of iron ore. In Friday's trading, share prices for mining giants BHP Billiton and Rio Tinto were down over 6% and Fortescue Metals was down as much as 18%. Businesses in Melbourne that had felt somewhat insulated because of the China effect now are admitting to ConGen Melbourne that it is no longer a question of "if" an economic downturn will touch them, but "when."

15. (SBU) Agricultural analysts note some problems. Until recently, Australian farmers had been somewhat sheltered from declining food prices by the weakening Australian dollar. Qdeclining food prices by the weakening Australian dollar. But now there are fears that some of the exporters who have replaced the former monopolist Australian Wheat Board are having problems accessing credit to buy wheat and other crops from farmers. Farm groups are advising farmers to get what they can now, to be careful who they sell to, and not to sit on their products.

Unemployment Up

16. (U) The Australian Bureau of Statistics released the latest employment numbers October 9; seasonally-adjusted unemployment ticked up from 4.1% to 4.3%, still low, but a move in the wrong direction. It appears likely that unemployment will continue to move up in upcoming months, with some forecasts that it could hit 6% in 12-18 months.

Don't Panic

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17. (U) Prime Minister Kevin Rudd has been busy pronouncing on the economy this week. He pointed to overnight IMF predictions of 2%-plus growth to again assert that although things are "bad", the Australian economy would grow. Rudd also reassured depositors that Australian banks are sound. And on October 10, Rudd announced new legislation to guarantee for the first time the first A\$20,000 of all individual bank deposits (Opposition Leader Malcolm Turnbull said it should be A\$100,000). Banks' initial reactions have been divided, some asserting that the existing law which gives depositors first crack at the assets of a failed bank is adequate. Treasurer Wayne Swan is en route to Washington to participate in Bank/Fund meetings and the G-20.

18. (SBU) Comment: Australia's economic problems should not be exaggerated. Its banks appear to be sound, due in part to a different regulatory structure and less speculative mortgage lending. But they are being hurt by the reduced availability of international credit to fund domestic lending, and by all the stories of troubled banks coming from the US and Europe. The Australian economy, based on the most recent numbers, is still growing - but consumer and business confidence are down, and now some economists and analysts have begun to discuss the possibility of the first Australian recession since 1991. As noted earlier this week (reftel b), any lingering belief that somehow Australia is "decoupled" from the US economy by virtue of the emergence of China as its top trade partner (an idea post always considered to be unsound) should be completely discredited now. In fact, it is fair to ask now whether the commodities boom Australia has enjoyed since 2003 based in large part on China's appetite for Australian products might turn to bust - just as new mines and production facilities being built in response to high commodity prices prepare to come on line, bringing additional capacity to market.

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